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PROFESSIONAL MANAGERS ASSOCIATION

STATEMENT OF  
PROFESSIONAL MANAGERS ASSOCIATION

Before the  
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

September 10, 1985

Presented by

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Senator Stevens, Chairman, and members of the Senate Committee on Governmental Affairs, thank you for the opportunity to present the views of the Professional Managers Association (PMA) on S.1527, the Civil Service Pension Reform Act, introduced July 30, 1985, to cover post-1983 Federal employees. We would like, first, to thank you Senator Stevens for your pension forums in 1983 and 1984 in which PMA participated. We also appreciate your statement in your letter of December 1982, accompanying the retirement plan you proposed then, that until the majority of those affected by your proposals support it, you would not pursue passage. We urge that you continue to move carefully in this important area.

The subject of retirement is of keen interest to our members, Federal mid-level managers, who are greatly concerned about the effectiveness and efficiency of the Federal government.

As you know, our retirement system has come under attack in recent years. The public and Congress have been bombarded with myths and misconceptions about our retirement system. If there is public indignation over our retirement system, it has been manufactured and its basis is false. Recent studies have shown that the reasons advanced for offering Federal employees lesser benefits than presently provided -- Donald Devine's scare stories about the cost and financial condition of the Civil Service Retirement System (CSRS) and comparisons with private-sector practices -- are invalid. PMA urges that you proceed in the design of a retirement system for new Federal

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employees on a sound and fair basis, with thoughtful consideration of the ramifications.

Simple justice demands that the benefits promised those now covered by CSRS be delivered. While the Federal government is not breaking faith with new hires by offering lesser benefits since new hires have not been covered under a plan promising any specific benefits, PMA sees no reason for offering these employees lesser benefits and submits that doing so will be to the detriment of the Federal government.

We first briefly summarize our three principal problems and suggestions with respect to the proposed retirement plan and, following that, outline our reasoning in more detail.

First, the plan as proposed favors short-term Federal employees to the detriment of those who spend their careers in the Federal government. We suggest the plan be revised to provide a better balancing of the concerns of these two groups. We believe that coverage under Social Security provides the portability sought between Federal and private-sector employment. Under the plan as proposed, with such heavy emphasis on the defined contribution portion, the Federal government will find that it is establishing an expensive severance plan principally benefiting short-term Federal employees and that, rather than recruiting the best and the brightest for a career in Federal service, Federal employment will be used and viewed by such individuals primarily as a training program for future private-sector employment. PMA prefers that the plan to be established be a

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defined benefit plan and that the contributions of the Federal government for retirement should go only to the defined benefit plan. If the Federal government wishes to provide a method for tax-deferred savings in addition, we suggest that it be funded entirely by voluntary employee contributions. The defined contribution portion of this proposed plan does not provide the flexibility and range of options for employees that it purports to because those employees who do not wish to contribute to the defined contribution part of the plan and those who cannot afford to must forfeit the Federal government's contribution. In effect, those who can and do contribute to the defined contribution plan will receive a higher rate of contribution from the Federal government than those who do not or cannot contribute. PMA feels that this is inequitable. Moreover, the rate of employee contribution required to receive the maximum contribution from the Federal government is too high. Finally, in light of the Reagan administration's proposal on September 3, 1985, to eliminate Section 401(k) pension plans, we doubt that the tax deferral of employee contributions to the defined contribution portion of the proposed plan would last any length of time after enactment. At any rate, all of us already have the opportunity to save, on a tax-deferred basis, some of our income for retirement by establishing an IRA.

Second, PMA is unwilling to forego for new Federal hires the only two features of Federal employment that are better than the average private-sector employment -- full cost of

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living adjustments to retirement benefits and the opportunity to retire at age 55 after 30 years of service without reduction of benefits. In every other aspect of compensation -- total compensation, cash compensation, the amount of retirement benefits at age 65, and every other fringe benefit -- even the average private-sector firm does better for its employees than does the Federal government. Further, the BLS (Bureau of Labor Statistics, U.S. Department of Labor) study, Employee Benefits in Medium and Large Firms, 1983, Bulletin 2213, issued in August 1984, found that 21 percent of pension plan participants were covered by pension plans permitting retirement at age 55 and 30 years of service, or lower, with no reduction on account of age.

Third, the proposed plan is modeled too closely on private-sector plans -- and the average or mediocre ones at that -- and incorporates features which are problems in private-sector plans which need correction and should not be imitated by the Federal government.

It is PMA's position that the pension plan adopted for Federal employees hired after December 31, 1983, plus the Social Security benefits attributable to their years of Federal service, should equal the benefits now provided by the CSRS to pre-1984 employees. And PMA recommends that the pension plan adopted for these employees be a defined benefit plan. We welcome an opportunity for employees to save and invest on a tax-deferred basis. However, unless the Federal government can provide and contribute to this opportunity on top of benefits

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from a defined benefit plan and Social Security which are equivalent to benefits now provided under CSRS, we suggest that, if such a benefit is offered, it be financed solely by voluntary employee contributions.

On the subject of defined benefit and defined contribution plans, we draw the Committee's attention to the fact that the Reagan administration has come out in favor of the defined benefit plan approach -- at least for pension plans in the private-sector. Two former Reagan administration officials, while in the Reagan administration administering the Employee Retirement Income Security Act of 1974, the law regulating private-sector retirement plans, stated that defined benefit plans offer a far better method of providing retirement income than defined contribution plans. Both Robert A. G. Monks, the former administrator of the U. S. Department of Labor's Office of Pension and Welfare Benefit Programs, and Charles C. Tharp, former executive director of the Pension Benefit Guaranty Corporation, while holding those positions in the Reagan administration, have stressed the superiority of defined benefit pension plans. See Pension and Investment Age, October 29, 1984, page 9, for a report of their remarks.

Mr. Monks told attendees at the meeting of the American Society of Pension Actuaries that defined contribution plans "are simply tax-aided savings plans," and compared defined contribution plans to "massive individual speculation." He

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also stated that defined benefit plans provide the best means of providing benefits to employees.

Mr. Tharp stated to attendees of the Southern Pension Conference and the pension actuaries' meetings that defined benefit and defined contribution plans "have proved best adapted to difference purposes." He stated, "Defined contribution plans are well-suited to capital accumulation for medium term objectives." He further stated that defined benefit plans are "distinctly superior" to defined contribution plans. They encourage orderly retirement from the work force, help limit turnover among those not yet at retirement age, provide past service credit and are more adaptable, and place the burden of investment risk on the employer. "In the coming year in Washington, we may be facing a great debate on the overall shape of our pension system in America," Mr. Tharp said. Limiting the system in favor of savings plans or in the pursuit of short-term revenue gains "will be detrimental to employees, employers and the long term health of our economy," he concluded.

Similar views have been expressed by Senator Jacob Javits, the "father of ERISA."

I would also like to quote, in part, the editorial on page 10 of the October 29, 1984 issue of Pension and Investment Age:

The Reagan administration finally has come out in support of defined benefit plans, as a story on page 9 of this issue reports. Not that the administration was opposed to defined benefit plans; it simply had been silent on

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whether defined benefit or defined contribution plans were to be favored. Now, Robert A.G. Monks, the Department of Labor's pension administrator, and Charles Tharp, executive director of the Pension Benefit Guaranty Corp., have declared, in separate speeches, that the administration stands behind defined benefit plans as the most efficient way to provide retirement benefits. This could be good news for pension beneficiaries and pension fund sponsors if the administration makes its commitment known to the congressional tax writing committees. The defined benefit plan is the cornerstone of the private pension system. While defined contribution plans have their place, a pension system built only on defined contribution plans would be unstable, at least as defined contribution plans are now designed. A pension system built only on defined contribution plans would be like a house built on sand. The features of the house might be very attractive, but the foundation is porous. . . . Another disadvantage is that the plan participant takes the investment risk in a defined contribution plan. The employer takes the risk in the defined benefit plan. . . .

PMA agrees with these views. We believe it unfair to finance the retirement benefit an employee needs to maintain his pre-retirement standard of living in such a way that the amount of the pension cannot be predicted until retirement and the amount is subject to market conditions prevailing at the time of retirement. PMA believes that a defined contribution plan should provide only extras, not basic economic security. Furthermore, we believe you will find that the defined contribution portion of the proposed plan will be more expensive to the Federal government than anticipated.

Defined contribution plans can be more costly to the employer than defined benefit plans in providing given benefits,



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as was pointed out at the December 13, 1983 pension forum sponsored by this committee. At that forum the president of Martin E. Segal Company pointed out that, for a given contribution a defined benefit plan can generally provide more in the way of benefits than can a defined contribution plan. Annual pay-outs are higher under a defined contribution plan than under a defined benefit plan because of payments made to those who leave before retirement.

On the subject of cost, covering Federal employees under Social Security has an impact. One is that it will cost the Federal government more to provide the same benefits that are provided under CSRS.

Some of the contributions to Social Security to be made by the Federal government as employer on behalf of Federal employees will be redistributed from Federal workers to private-sector workers. The benefit redistribution to non-Federal employees is caused by Social Security coverage of all types of employment including temporary, part-time, and minimum wage jobs that are not common in the Federal government. This cost to the Federal government for covering Federal employees under Social Security is a cost which does not translate into a benefit for any Federal employees. Since Congress saw fit to put new Federal employees under Social Security, it seems unfair for Congress to bring up now the subject of the cost of that action and expect Federal employees to absorb that cost by receiving lesser benefits.

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Being covered under Social Security has its benefits -- for some. Social Security is portable. This benefit is valuable to workers who leave Federal service, but portability is of no value to employees who spend their careers in the Federal government. Thus, this cost does not translate into a benefit for employees who spend their careers in the Federal government.

One of the most widespread misconceptions, even occasionally among Federal employees, is that CSRS is overly generous. On the contrary, generally CSRS provides at most merely adequate, certainly not opulent, benefits. In the past CSRS had been considered comparatively generous to Federal employees as a partial offset to lower salaries of Federal employees when compared with private-sector pensions and salaries. Now the CSRS is inferior to many private-sector retirement systems.

The general consensus is that retirees should be able to maintain the standard of living attained during their working years into their retirement years. In the private-sector, it has been estimated that 50 to 80 percent of the current value of an employee's gross compensation at retirement is needed to enjoy a post-retirement standard of living reasonably comparable to the pre-retirement standard of living. That estimate was based on Social Security benefits not being taxable, the assumption that the retiree's home and furnishings are paid for, the assumption that the retiree is in a lower tax bracket, and the assumption that the retiree has fewer other expenses.

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However, experts concede that the actual aggregate reduction in the financial needs of a retired person has been exaggerated and that a much higher percentage is needed. CSRS benefits are totally taxable. An employee who retires from the CSRS after 30 years of service with unreduced benefits will receive only 56.25 percent of the three highest years' average salary. That translates to about 53 percent of final gross salary. The 56.25 percent is reduced for those who provide their spouse with a survivor annuity, as most do, generally to 51 percent, and that 51 percent translates to less than 50 percent of final gross salary. Thus, CSRS presently does not meet even this erroneously low standard for an employee retiring after 30 years with unreduced benefits (except for the reduction for survivor benefit for the spouse).

The maximum pension benefit that can be earned by a civil service employee is 80 percent of the average of the 3 highest years of salary and that requires 41 years and 10 months of service. On the other hand, it is not uncommon for employees in the private sector to receive much higher benefits. This is borne out by a provision of the Employee Retirement Income Security Act of 1974 (ERISA), which regulates private-sector pension plans. ERISA prohibits private-sector defined benefit qualified pension plans from providing benefits higher than the lesser of (1) \$90,000, adjusted for inflation, or (2) 100 percent of the participant's average compensation for the highest 3 consecutive years. These limits are based on benefits

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attributable only to employer contributions. Benefits can be higher than these limits based in part on employee contributions or when provided outside the qualified plan through excess benefit pension plans and other types of non-qualified plans, financed generally by the employer.

The CSRS is merely comparable to or, in some cases, inferior to the combination of benefits provided through the pension plans of the more progressive companies in the private sector and Social Security. And, when you consider additional benefits provided by many private-sector companies, such as stock, profit-sharing, savings and thrift plans, excess benefit plans, etc., there is an even greater disparity. And, let's not forget, these benefits are based on larger salaries -- witness the large number of political appointees, many young and in the early years of their careers, who leave the Federal service after brief appointments because they claim they can no longer live on such low pay. And most of them are paid at the executive-schedule rate, which is higher pay than almost all Federal civil servants receive.

The above statements have been confirmed by the study prepared by Hay/Huggins Company and Hay Management Consultants for the House Committee on Post Office and Civil Service, entitled Study of Total Compensation in the Federal, State and Private Sectors, December 4, 1984. That study showed that in total compensation (the total of cash compensation and fringe benefits) the Federal employee is 7.2 percent behind the

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private-sector employee on average and that it was expected that the 1985 update of the analysis will show the advantage of private-sector total compensation as 9 percent or more on average. Since that study included small companies, the differences would be even greater if only the large, progressive private-sector employers with work forces similar to that of the Federal government were studied. The study also showed that for employees at the \$30,000 pay level the CSRS is 3 percent less valuable than the benefits provided by any of the top 10 percent of private-sector employers in the study.

The study showed that the retirement benefits provided to employees of those top private-sector employers in the study cost the employers 25.1 percent of pay. If the Federal tax subsidy enjoyed by private-sector pension plans were taken into account, as it should be, that cost figure would be higher. The Congressional Research Service estimates the employer cost of the CSRS as 24.7 percent of pay. So, even without taking into consideration the tax subsidy enjoyed by private-sector plans, the cost, 25.1 percent of pay, of retirement benefits provided employees of the top employers in the study exceeds the cost to the Government of the CSRS. The study did find that the overall CSRS benefits are more valuable than private-sector retirement on average, although even the average private-sector pension plan provides better benefits at age 65 than CSRS (an 18 percent higher replacement rate of pre-retirement wages). It also found that the cash compensation and the

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other fringe benefits of private-sector employees were better on average than that of Federal employees -- and that the total compensation of Federal employees lags the private sector. As stated earlier, the study included small companies (employing as few as 100 employees) whose work forces are not comparable to the highly educated Federal work force, consisting in such large part of professional, technical, and administrative employees who are experts in many diverse fields -- managers, attorneys, employee benefit plan specialists, actuaries, accountants, scientists, program analysts, economists, etc.

PMA submits that it is unfair and intellectually dishonest to compare only one segment of compensation (retirement) when in every single one of the other segments of compensation (fringe benefits such as health insurance and life insurance and cash compensation) and in total compensation Federal employees are behind even the employees of the average private-sector firms. Moreover, it is unfair to compare Federal compensation with the compensation of the employees of the average or small private-sector firm when the Federal government's work force is so unlike such work forces.

PMA is very concerned that Congress now is considering offering to new Federal employees lesser benefits than CSRS provides based on some of the practices of the average private-sector pension plan. As noted earlier, some of these practices are problems which need to be corrected, not emulated by the Federal government as employer. ERISA was signed into law 11

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years ago and amendments have been made to it or the Internal Revenue Code every year since then to correct some of the undesirable aspects of private-sector plans. Since all of the problems have not yet been corrected, forums and commissions have been established and congressional hearings held to deal with the remaining problems. For example, while Social Security benefits are protected from inflation by the COLA's and while many private-sector employers have increased retirees' benefits because of inflation, one of the problems of many private-sector plans is the erosion of the retirement benefit over the years due to inflation. In fact, over the years, bills have been proposed in Congress regarding this problem and it will probably not be long before it is corrected.

Moreover, the fact of the matter is that the trend in employee benefits in the private-sector over the years has been to increase and improve employee benefits. Thus, with the passage of years more and more pension plans have improved their benefit formulas to base benefits on final gross earnings; more plans have lower retirement age for unreduced benefits; more plans provide post-retirement increases because of inflation. In such a climate why should the Federal government be considering cutting back on Federal employees' benefits? It should be proposing to improve employee benefits. A more generous retirement system is needed to make up for the less generous pay and other fringe benefits.

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The Federal deficit will not be cured by reducing Federal employees' pay package. However, if the Federal employee is made, incorrectly, to seem overpaid, the public's attention is focused on that misconception, rather than on facts such as that some individuals and corporations are not required to pay their fair share of taxes and that the American public is subsidizing through taxes some activities which it most certainly would not want to, if the facts were known and publicized.

Much has been made of the so-called burden of the American taxpayer in paying for Federal employees' pensions. PMA would like to point out that the American taxpayers employ the Federal employee and thus pay for our salaries and some of our benefits. However, little has been made of the fact that the American taxpayers are also subsidizing every private-sector employee's salary and pension because these are expenses which are deductible from their employer's taxes, are thus a revenue loss to the Federal government, and therefore are activities subsidized by the American taxpayer. Let us not forget that the American taxpayers are subsidizing J. Peter Grace's pension of over \$357,000 per year. The American taxpayers are subsidizing lavish business lunches, extravagant business entertainment, and planes and yachts and resort condominiums owned by corporations and flights on the Concorde taken by business executives. The American taxpayers are subsidizing those 40 large, profit-making firms that paid no income taxes in 1984 (according to the August 29, 1985 issue of the Wall Street Journal). PMA believes that the purpose behind some organizations' misrepresentations



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to the public on Federal pensions and other Federal expenditures is not a public-spirited one, but a self-serving one. The purpose of these groups' misleading the public about such matters is to keep public attention away from the real tax inequities in our society from which they benefit so lavishly and which we taxpayers are subsidizing. They want to concentrate attention on cutting Federal expenditures, whether fairly and wisely or not, so that our tax structure is not scrutinized.

Finally, we would like to make two points with respect to how the new plan will take into account the Social Security benefits earned. Since Social Security replaces a higher proportion of earnings for low-wage employees, it is not unreasonable that this "tilt" be taken into account. We note that the proposed plan does not take the "tilt" into account. We prefer that an "add on" approach be utilized because it is easier for employees to understand than an "integrated" approach. Perhaps an "add on" approach could be utilized with a higher rate of accrual for salaries over a specified level in order to make up for the Social Security "tilt". But, regardless of how Social Security is taken into account, it is very important that only that part of an employee's Social Security benefit attributable to Federal service be taken into account. If a specified percentage of an employee's entire Social Security is taken into account, even that part of Social Security attributable to private-sector employment, then Federal employees who have also worked in the private-sector will lose some or all of their benefits from the Federal retirement plan.

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We hope you will keep our concerns in mind when you consider this legislation. PMA earnestly desires that the plan adopted for Federal employees hired after December 31, 1983, be one which will enable retirees to maintain their pre-retirement standard of living in their retirement years and thus will be a plan which will be instrumental in attracting and retaining an efficient Federal work force. PMA will be happy to assist you in this most important enterprise.